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Analysis of Business Trends Plus Selected Financial Indicators

Eastern Europe's Dramatic Change

The political developments sweeping Eastern Europe in recent years have occurred with such breathtaking rapidity that the world has been left incredulous. But, just as significant is the fact that demands for political reform have been accompanied by calls to scrap the existing command economies and replace them with full-fledged free market systems. In order to achieve this ambitious goal, Western financial assistance and investment will be needed. And, while expectations must be kept realistic and an array of pitfalls exists, private investors face a variety of opportunities in these countries.

Until recently, direct investment played only a minor role in East-West economic relations. Instead, business between the blocs centered largely around trade, often on a barter basis, and banking relations. However, in the wake of the economic reforms undertaken in Eastern Europe, vastly greater attention is now being paid to attracting direct investment, a change in mood prompted by the necessity to modernize the means of production, privatize state-owned industry and introduce quickly Western managerial skills and methods.

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While all types of reform measures are being discussed, privatization is one of the linchpins around which the success, or failure of economic modernization and liberalization in Eastern Europe will hinge. Not only does it hold out the promise of capital to rebuild Eastern Europe's woefully uncompetitive industrial base but, if successful, it will also create a new entrepreneurial culture. The task ahead, however, is far from easy. In order to attract foreign investment, one of the first priorities that Eastern European countries must tackle is the need to introduce a legal system that recognizes private ownership of property and clearly codifies the rights and responsibilities of such owners. This is because foreign investors must know whether they can buy and sell land, both for their own personal use and for the operations of their business.

And, that is just a start, albeit an essential one. In most cases, newly-democratic governments are starting from scratch, having to draw up new ways of doing business, assessing assets and learning on the job. The task is further complicated by an inadequate, if not non-existent, infrastructure, a skeptical population and a largely obsolete capital stock. There has been much resistance to privatization throughout Eastern Europe, due to several factors. For one thing, there is the concern about job losses. For another, some people fear that their country may be sold off too cheaply to foreign investors.

Joint Ventures Ease Western Access

Perhaps the best way to lessen such resistance, while encouraging foreign investment, is through joint ventures, in which the citizens of the recipient country retain substantial participation. Joint ventures between foreign and domestic partners are a form of Western direct investment in Eastern Europe. Nearly 16,000 of these transactions existed at the beginning of this year, according to the Austrian Economics Ministry, compared with less than 600 at the beginning of 1989. In general, the domestic partner is responsible for infrastructure—land and buildings, for example—as well as communications and staff. At the same time, the foreign partner provides technological, marketing and management know-how and takes care of foreign exchange requirements. The foreign investor is interested in, and obtains, a presence in Eastern European markets with their attractive wage levels and generally skilled pool of labor.

Over the past year, Hungary, where the process of liberalization is relatively advanced, has enjoyed the distinction of garnering the most foreign investment of any country in the former East bloc—about $1 billion—while fast-changing Poland attracted about half as much. Among the larger transactions have been the purchase of the Tungsram electric bulb group in Hungary by General Electric a year ago, and the purchase of Zameck, the Polish Turbine manufacturer, by ABB of Switzerland. There have been sizable deals in other countries as well, such as the 70 percent share of the Skoda car works in Czechoslovakia acquired by Volkswagen of Germany last year. But, notwithstanding these highly-publicized transactions, the

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process of privatization of companies which need substantial infusions of capital and wholesale restructuring has taken place only very slowly.

Human Capital Needs Upgrading

A central feature in the rebuilding of Eastern Europe will have to be the enhancement of human capital. Although the labor force in these countries is generally skilled, the combination of an obsolete capital stock and minimal material incentives has kept productivity abysmally low, with devastating effects on product quality and competitiveness. Although additional training, mainly on the job, will help, it will not reverse quickly four decades of lethargic performance. New talents will have to be developed, while such free market virtues as creativity, initiative and personal leadership, which were not highly valued in the former command economies, must be nurtured.

While impatience pervades Eastern Europe, long-term progress will only be achieved step-by-step. The amount of institutional change needed is enormous. A modern banking system must be developed—one which allocates scarce resources to their most productive uses, rather than by political fiat. Prices must be freed from rigid control, currencies made convertible, pri-

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/12/91)	193,755	- 648	- 20,431
New York City (6/19/91)	31,491	- 545	- 7,738
Commercial Paper (6/19/91)	546,258	+ 1,026	- 4,110

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/12/91)	309,496	- 2,455	- 12,696
New York City (6/19/91)	56,004	+ 629	- 2,079

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/12/91)	1,037,457	- 2,450	+ 24,072
New York City (6/19/91)	173,051	- 305	- 9,826

Financial Markets

	Friday 6/28/91	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.68%	- .03	- 2.31
180-Day Bills†	5.92	- .07	- 2.08
Longest Bills†	6.30	- .02	- 1.73
Recent Issues:			
7s 6/30/93 (When Issued)	6.89	NA	
7⅞s 6/30/96 (When Issued)	7.88	NA	
8s 5/15/01	8.23	- .09	
8⅛s 5/15/21	8.41	- .11	
Municipals:			
Bond Buyer—20 Bond Index* (6/27/91)	7.13%	- .02	- .14
Blue List Total ($ Million)	$1,394	- $ 93	- $ 32
30-Day Visible Supply ($ Million)	$1,405	- $1,553	- $424
Total	$2,799	- $1,646	- $456
Corporates:			
Moody's Aa Composite (6/27/91)	9.30%	- .01	- .20
30-Day Visible Supply ($ Million)	$ 375	- $ 25	- $845
Stocks:			
Dow-Jones Averages:			
Industrials	2,906.75	- 58.81	+ 26.06
Transportation	1,153.22	- 37.37	+ 10.52
Utilities	196.81	- 1.00	- 13.14
65 Stocks	1,030.92	- 22.24	- .05
N.Y.S.E. Composite Index	203.51	- 3.36	- 8.03
N.Y.S.E. Avg. Daily Vol. for Week (000's)	159,990	- 364	+19,234

*34% Taxable equivalent 10.80%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/28/91	Week Ago
Overnight	5.25%	5.75%
1 month	6.00	5.94
3 month	6.06	6.00
6 month	6.44	6.25
1 year	6.88	6.75

FOREIGN EXCHANGE SPOT RATES

New York Opening (6/28/91)	Currency Per U.S. $	Week Ago
Belgium	37.33	37.05
Canada	1.1415	1.1421
France	6.1400	6.1115
Germany	1.8120	1.7984
Italy	1349.00	1339.00
Japan	138.08	138.45
Mexico	3021.80	3019.00
Netherlands	2.0426	2.0260
South Korea	710.87	711.86
Switzerland	1.5595	1.5460
Taiwan	26.83	26.90
U.K.*	1.6215	1.6308

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (6/28/91) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.3%	-6.0%

vatization encouraged and new businesses formed. People who possess skills in marketing, accounting, finance and taxation and personnel management are desperately needed. Foreign capital will bring new technology and management skills, which are vital. But there is no escape from the painstaking, case-by-case process of building the institutions and systems which are needed. That means building organizational structures, changing deep-seated attitudes and the development of a new entrepreneurial culture.

Most East European governments do not want a "middle way" between communism and capitalism. Their ambition is to create full-fledged market economies based upon the Western model as soon as possible. This reform process will pose a unique challenge to foreign investors as well. They must come up with their own initiatives to support the rapid pace of change that is underway in the former Eastern bloc. Without technical help from abroad, Eastern European countries will simply not be able to make efficient use of the sizable loans from Western governments. Implementing the changes which will transform Eastern Europe into efficient market-oriented economies is one of the most pressing economic challenges of the decade. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 6/26/91	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	253.714	+ 1.180	+17.692
Loans to Depository Inst.	.363	+ .119	- .261
Float	.144	- .366	- .403
Total Reserve Bank Credit	291.253	+ 1.144	+13.356
Treasury Deposits with Federal Reserve Banks	5.745	- .232	+ .382
Currency in Circulation	290.553	- .358	+25.085
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	243.915	- 3.754	+16.550
Member Bank Reserves:	6/26/91		
Total Reserves Held	50.410	+ .263	- 9.050
Excess (Deficiency)	1.311	+ .575	+ .294
Net Free Reserves	1.005	+ .543	+ .371

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	% Change Since Year Ago
M1 (6/17/91)	860.7	+ 7.9	+ 6.0
M2 (6/17/91)	3,406.4	+ 3.4	+ 3.8
M3 (6/17/91)	4,176.2	0.0	+ 2.6
Domestic Nonfinancial Debt (1st Q'91)	10,634.2	+ 2.8	+ 5.5

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 6/28/91	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	5.55%	5.72%	5.98%
* Federal Agencies	5.95	6.10	6.55
* Municipal Notes–High Grade (34% Taxable Equivalent)	6.36	6.52	6.82
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	6.10	6.32	6.80

‡ Finance Company Paper–Prime

5- 14 days	5.93%
15- 29 days	5.95
30- 59 days	5.98
60- 89 days	5.98
90-179 days	5.85
180-239 days	5.88
240-270 days	6.05

‡* Bankers' Acceptances

Jul.	5.95%
Aug.	5.95
Sep.	5.95
Oct.	6.00
Nov.	6.02
Dec.	6.02

‡ Industrial Paper–Prime

30- 89 days	6.07%
90-120 days	6.10

†Federal Funds Effective Rate 6.25%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'91	$ 5,558r	$ 5,527	$ 5,375
Gross National Product (1982 Dollars)*	1st Q'91	$ 4,124r	$ 4,153	$ 4,151
Percent Change, Annual Rate	1st Q'91	- 2.8r	- 1.6	1.7
Change in Consumer Prices*	May '91	3.6%	2.4%	2.4%
Change in MH Cost of Living Index*	May '91	2.4%	7.2%	3.6%
Change in Producer Prices*	May '91	7.2%	2.4%	3.6%
Civilian Employment (Thousands of Persons) †	May '91	116,591	117,398	118,277
Unemployment as % of Civilian Labor Force †	May '91	6.9%	6.6%	5.3%
Personal Income*	May '91n	$ 4,779	$ 4,755	$ 4,621
Leading Indicators Composite Index (1967=100) †	May '91n	143.1	142.0r	146.0
Industrial Production Index (1977=100) †	May '91	105.8	105.3	109.4
Net Change in Consumer Installment Credit †	Apr '91	$ 1.70	- $ 0.32	$ 1.12
U.S. Merchandise Trade Balance †	Apr '91n	- $ 4.78	- $ 4.07r	- $ 7.62
Plant and Equipment Expenditures*	3rd Q'91	$ 553.5(a)	$ 544.2(a)	$ 534.9
Private Housing Starts (Thousands of Units)*	May '91n	982	981r	1,208
New Construction Expenditures*	Apr '91	$ 392.6	$ 389.3	$ 444.7
Total Business Inventories †	Apr '91	$ 815.2	$ 819.6	$ 813.0
Total Business Sales †	Apr '91	$ 529.6	$ 523.1	$ 535.4

*Seasonally adjusted annual rate. † Seasonally adjusted.
n-Newly reported figure. r-Revised. a-Anticipated.

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